

**Office of Chief Counsel
Internal Revenue Service
Memorandum**

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to: Daniel P. Longhi
IRS DOJ Government Settlement Liaison
(Large Business & International)

from: William V. Spatz
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subject: The Application of I.R.C. § 7602(c) to Government Contacts in the Context of
Department of Justice (DOJ) Settlements with a Taxpayer

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUES

1. Whether an IRS request to the Department of Justice (DOJ) for documentary information – including, but not limited to, a Financial Management Information Systems (FMIS) report, correspondence, memoranda, or external or internal emails – concerning DOJ's settlement discussions with a taxpayer against whom the government had a non-tax cause of action is considered a third-party contact for purposes of I.R.C. § 7602(c).
2. Whether the answer to the first question is any different if an IRS agent asks the DOJ attorney who handled and/or settled the government's non-tax cause of action against the taxpayer a series of verbal questions about any of DOJ's discussions with the taxpayer (or the taxpayer's representatives) concerning the government's assertion of penalties.

CONCLUSIONS

1. Generally, IRS contacts with non-IRS federal, state, local, or foreign government agencies or their employees are not considered third-party contacts, under Treas. Reg. § 301.7602-2(f)(5). An exception to this general rule exists if the IRS contact with another government agency concerns that other government agency's business (such as a taxpayer contract with or employment by the other agency) with the taxpayer. So long as the subject matter of the government's cause of action is not the taxpayer's employment by or contract with DOJ, the exception to the general rule does not apply, meaning third-party contact procedures would not apply to the contact.

2. No. The general exception that IRS contacts with a non-IRS government employee are not considered third-party contacts applies equally to IRS verbal discussions with the non-IRS government employee as to a formal request for documentary information. The very limited, in context, exception to this general rule for when the subject matter of the government's cause of action concerned the taxpayer's employment by or business contract with the DOJ here, would also be applied the same way.

FACTS

Generally, under I.R.C. § 162(f), a taxpayer may not deduct from taxable income any amount paid or incurred (whether by suit, agreement, or otherwise) to, or at the direction of, a government or governmental entity in relation to the violation of any law or the investigation or inquiry by such government or governmental entity into the potential violation of any law. To evaluate whether or not a government settlement with a taxpayer involved non-deductible penalties, the IRS may review the government's underlying cause of action, the documents filed in a lawsuit (if one was filed), and the discussions surrounding the settlement agreement. In many instances, the IRS requests information about these matters from DOJ, which generally represents U.S. government agencies in litigation and in matters referred by such agencies for litigation.

The questions above arise in the context of the IRS's requests for information from the DOJ about the government's non-tax lawsuit or cause of action against a taxpayer. An IRS agent might contact a DOJ attorney with knowledge of the case and request a DOJ-generated FMIS audit report and/or other information about the manner in which DOJ handled and/or settled the lawsuit or cause of action with the taxpayer.

The IRS is ordinarily required to inform a taxpayer that IRS employees intend to contact third parties as part of an examination or collection proceeding under I.R.C. § 7602(c) and Treas. Reg. § 301.7602-2. You requested our advice on whether the IRS's requests for information from the DOJ—whether for documentary information or verbal discussions with the DOJ—regarding the government's settlement with a taxpayer of a non-tax cause of action are considered third-party contacts for which I.R.C. § 7602(c)'s advance notice and post-contact reporting rules apply.

LAW AND ANALYSIS

Background on Third-Party Contact Rules

The scenarios above are governed by the third-party contact provisions found in I.R.C. § 7602(c) and Treas. Reg. § 301.7602-2. Third-party contact rules provide that when an IRS employee intends to contact third parties with respect to the determination or collection of the tax liability of a taxpayer, the IRS is generally required to provide advance notice to the taxpayer of the IRS employee's intent to make such third-party contacts. I.R.C. § 7602(c)(1). A "third party contact" is generally defined as any communication which (1) is initiated by an IRS employee; (2) is made to a person other than the taxpayer; (3) is made with respect to the determination or collection of the tax liability of such taxpayer; (4) discloses the identity of the taxpayer being investigated; and (5) discloses the association of the IRS employee with the IRS. Treas. Reg. § 301.7602-2(b).

History and Purpose of I.R.C. § 7602(c)

When third-party contact provisions were first added to the Code, Congress intended to strike a balance between the competing interests of a taxpayer in its reputation, of third parties in their privacy, and of the IRS in its responsibilities to administer the internal revenue laws effectively. Congress struck this balance in the IRS Restructuring and Reform Act of 1998 (RRA 98), by requiring the IRS to provide taxpayers with a "general notice" that provided "reasonable" advance notice to the taxpayer that contacts with persons other than the taxpayer "may be" made, and by providing various exceptions to IRS pre-contact notice or post-contact reporting.

The preamble to Prop. Treas. Reg. § 301.7602-2, 66 Fed. Reg. 77-78 (Jan. 2, 2001) (hereinafter NPRM (Notice of Proposed Rulemaking)) describes this balancing approach with which the IRS interprets and administers I.R.C. § 7602(c):

The provision as enacted and the particular changes made by the Conference Committee to the Senate proposal support an interpretative approach that balances taxpayers' business and reputational interests, articulated as the principal impetus for the Senate proposal, with third parties' privacy interests and the IRS' responsibility to administer the internal revenue laws effectively.

The preamble to the final regulations adopted this approach without change. In pertinent part, it provides:

[T]he final regulations balance a taxpayer's business and reputational interests with third parties' privacy interests and the

IRS' responsibility to administer the internal revenue laws effectively.

The Taxpayer First Act of 2019 Amendment to I.R.C. § 7602(c)

Under the Taxpayer First Act of 2019, P.L.116-25, Congress struck the word “reasonable” before “notice,” and instead set forth the specific characteristics of advance notice that it thought would be sufficient for its balanced purposes. The new elements of advance notice are that the IRS:

- actually intend (not “may”) to contact third parties;
- notify the taxpayer of this intention;
- generally notify a taxpayer at least 45 days before it contacts a third party; and
- tell the taxpayer the time period in which it intends to make the contact and the period may not be more than one year, subject to renewal.

Importantly, the Taxpayer First Act did not change what the IRS considers to be a third-party contact.

Issue 1. IRS Documentary Evidence Request to Non-IRS Governmental Entity

The Governmental Entities Exception

Although I.R.C. § 7602(c) notice rules generally apply to IRS contacts with any “person other than the taxpayer,” and the statute contains no explicit exception for contacts with governmental entities, Treas. Reg. § 301.7602-2(f)(5) specifically carves out a governmental entities exception. The regulation provides that “Section 7602(c) does not apply to any contact with any office of any local, state, Federal or foreign governmental entity” and that “[t]he term office includes any agent or contractor of the office acting in such capacity.” Treas. Reg. § 301.7602-2(f)(5).

Looking at the legislative history of RRA 98, it appears Congress did not intend to require notice to taxpayers for government contacts because those contacts do not implicate the concerns that underlie the statute’s enactment. The NPRM specifically points to the 1998 Senate Finance Committee Report on RRA 98, which states “[c]ontacts with the government officials relating to matters such as the location of assets or the taxpayer’s current address are not restricted by this provision.” S. Rep. No. 105-174, at 77 (1998). As the NPRM explains, “[t]his report language suggests that Congress did not generally consider government contacts to implicate taxpayer business and reputational interests to the same degree as other types of third-party contacts.”

Generally not requiring notice for government contacts is consistent with striking the balance between the taxpayer’s reputation, third parties’ privacy, and the IRS’s

enforcement of the law. Indeed, the NPRM explains that “[i]n determining and collecting taxes, IRS employees often contact other government entities” and among the list of non-IRS governmental entities the IRS employees may need to confer with are “[DOJ] employees, and other federal government employees with respect to the determination or collection of a taxpayer’s liability.” The NPRM further explains that notice for government contacts is generally unnecessary because they are less likely “to affect taxpayers’ reputations among persons with whom taxpayers have business relationships” and because government officials have “duties not to disclose IRS contacts to the general public.” Moreover, the NPRM continues, the “administrative burden on the IRS of maintaining and providing to taxpayers records of government contacts would be substantial because of the high volume of government contacts,” and requiring notice “could delay and otherwise impair administration of the tax laws.”

In balancing taxpayer-friendly provisions with IRS responsibilities to continue to administer the internal revenue laws effectively, the Treasury Department and the IRS determined that government contacts are generally not third-party contacts as defined in § 301.7602–2(b) and are generally not subject to I.R.C. § 7602(c) procedures for advance notice or post-contact reporting of contacts with third parties.

The Exception to the Governmental Entities Rule

An exception to this general rule exists if the IRS contact with another government agency concerns that other government agency’s business relationship with the taxpayer. Treas. Reg. § 301.7602-2(f)(5) carves out this narrow exception to the types of government contacts not subject to application of I.R.C. § 7602(c) for “contacts concerning the taxpayer’s business with the government office contacted, such as the taxpayer’s contracts with or employment by the office.”

The NPRM explains this “exception to the exception,” noting there might be limited instances when a government unit contact by the IRS could impact a taxpayers’ business and reputational interests with the contacted government unit when the taxpayer and the government unit have a business relationship. The NPRM states that “[s]ome government contacts, however, may affect taxpayers’ business relationships with the government and so will be treated as subject to the statute. The proposed regulations recognize taxpayers’ interest in their business relations with governmental entities by providing that contacts concerning a taxpayer’s conduct of business with the particular government office contacted will be subject to the statute.”

Here, in the case of an IRS request to DOJ for documentary evidence from the government’s non-tax lawsuit against a taxpayer, an IRS employee’s request to a DOJ attorney for documentary information (such as a FMIS report) on a taxpayer who violated a federal law is a contact with a governmental entity within the meaning of Treas. Reg. § 301.7602-2(f)(5). As such, it is not a third-party contact for purposes of I.R.C. § 7602(c), so long as the government’s cause of action against the taxpayer was not based on the taxpayer’s employment by or contract with DOJ.

Issue 2. IRS Verbal Discussions Request to Non-IRS Governmental Entity

The general exception that IRS contacts with a non-IRS government employee are not considered third-party contacts applies equally to IRS verbal discussions with the non-IRS government employee as to a formal request for documentary information. The limited, in context, exception to this general rule for when the subject matter of the government's cause of action concerned the taxpayer's employment by or business contract with the DOJ here, would also be applied the same way.

Therefore, if an IRS employee discusses with a DOJ attorney the manner in which DOJ handled or settled a lawsuit on behalf of the United States with a taxpayer who allegedly violated a non-tax federal law, the discussion would not qualify for the contract or employment relationship exception to the general government contacts exception in Treas. Reg. § 301.7602-2(f)(5), and is not a third-party contact for purposes of I.R.C. § 7602(c), so long as the government's cause of action against a taxpayer is not based on the taxpayer's employment by or contract with DOJ.

The presence or absence of a verbal discussion could be relevant to whether another type of IRS interaction is considered a third-party contact, however. An IRS employee's use of a commercial (or government) online research service or Internet website to obtain information relevant to an IRS investigation of the taxpayer is not a third-party contact because there is no contact with a "person" other than the taxpayer. See Treas. Reg. §§ 301.7602-2(c)(2)(i)(B) and (c)(2)(ii)-Example 3. The general exception to third-party contacts for IRS contacts with other government agencies or their employees is separate from the exception for commercial (or government) online research services or Internet research.

Please call (202) 317-3400 if you have any further questions.

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